



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-125761-14]

RIN 1545-BM58

Nondiscrimination Relief for Closed Defined Benefit Pension Plans and Additional Changes to the Retirement Plan Nondiscrimination Requirements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that modify the nondiscrimination requirements applicable to certain retirement plans that provide additional benefits to a grandfathered group of employees following certain changes in the coverage of a defined benefit plan or a defined benefit plan formula. The proposed regulations also make certain other changes to the nondiscrimination rules that are not limited to these plans. These regulations would affect participants in, beneficiaries of, employers maintaining, and administrators of tax-qualified retirement plans.

DATES: Written or electronic comments and must be received by **[INSERT**

**DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

Outlines of topics to be discussed at the public hearing scheduled for May 19,

2016 at 10 a.m., must be received by **[INSERT DATE 90 DAYS AFTER**

**PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-125761-14), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington D.C. 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-125761-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-125761-14).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Kelly C. Scanlon and Linda S. F. Marshall at (202) 317-6700; concerning submissions of comments, the hearing, and/or being placed on the building access list to attend the hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### **Background**

Section 401(a)(4) provides generally that a plan is a qualified plan only if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees. In 1991, the Treasury Department and the IRS issued comprehensive regulations under section 401(a)(4) (TD 8360, 56 FR 47524) setting forth several alternative methods for testing compliance with this statutory requirement. In 1993, the Treasury Department and the IRS made significant amendments to those regulations (TD 8485, 58 FR 46773).

Under the section 401(a)(4) regulations, a plan is permitted to demonstrate that either the contributions or the benefits provided under the plan

are nondiscriminatory in amount, regardless of whether the plan is a defined benefit or defined contribution plan. See §1.401(a)(4)-1(b)(2). In order to test a defined contribution plan on the basis of benefits, the amounts allocated to employees under the plan must be converted to equivalent benefits. This conversion is done using an interest rate between 7.5% and 8.5%.<sup>1</sup> In addition, for purposes of section 401(a)(4), a defined benefit plan and a defined contribution plan are permitted to be aggregated and treated as a single plan pursuant to §1.401(a)(4)-9, which refers to such an aggregated plan as a DB/DC plan.

After issuance of the final regulations, a new type of plan design developed. This type of plan is often referred to as a “new comparability” plan and is typically a defined contribution plan that provides higher allocation rates to an older and more highly compensated group of employees. This type of plan nonetheless satisfies the nondiscrimination requirements by testing the contributions on the basis of equivalent benefits because the conversion to equivalent benefits reflects assumed growth to normal retirement age and therefore results in relatively lower equivalent benefits for the highly compensated employees who are closer to normal retirement age. The Treasury Department and the IRS concluded that this type of plan was inconsistent with the intent behind the nondiscrimination regulations. Consequently, the Treasury Department and the IRS amended the section 401(a)(4) regulations in 2001 to

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<sup>1</sup> See §1.401(a)(4)-8(c)(2)(ii) and §1.401(a)(4)-12 (definition of standard interest rate). This standard interest rate is used to determine assumed growth of a defined contribution plan account and to convert the projected account balance to an annuity at normal retirement age.

require that a new comparability plan provide a higher minimum contribution to nonhighly compensated employees<sup>2</sup> in order for the plan to be eligible to demonstrate compliance with the nondiscrimination requirements of section 401(a)(4) on the basis of equivalent benefits (TD 8954, 66 FR 34535) (the “2001 amendments”).

This higher minimum contribution requirement was directed at the new comparability plans. Other defined contribution plans that provide “broadly available allocation rates” or allocation rates that are “based on a gradual age or service schedule” are not subject to the higher minimum contribution requirement even if they demonstrate compliance with the nondiscrimination requirements of section 401(a)(4) on the basis of equivalent benefits.<sup>3</sup> In addition, under the 2001 amendments, defined benefit replacement allocations (“DBRAs”) may be disregarded when determining whether a defined contribution plan has broadly available allocation rates. The 2001 amendments also prescribe rules regarding DB/DC plans that provide for benefits in a manner similar to new comparability plans. Under these rules (contained in §1.401(a)(4)-9(b)(2)(v)), in order for a DB/DC plan to be eligible to demonstrate compliance with the section 401(a)(4) nondiscrimination requirements on the basis of equivalent benefits, it must satisfy a minimum aggregate allocation gateway unless the DB/DC plan either fits within the definition of “primarily defined benefit in character” or consists of “broadly available separate plans.” This minimum aggregate allocation gateway requires

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<sup>2</sup> This higher minimum contribution rate is required under §1.401(a)(4)-8(b)(1)(i)(B)(3) and (b)(1)(vi)..

<sup>3</sup> See §1.401(a)(4)-8(b)(1)(i)(B)(1) and (2), (b)(1)(iii), and (b)(1)(iv).

a minimum allocation rate (or equivalent allocation rate) for each nonhighly compensated employee.

Since 2001, a number of employers have moved away from providing retirement benefits through traditional defined benefit plans. In many of these cases, employers have either significantly changed the type of benefit formula provided under the plan (such as in the case of a conversion to a cash balance plan), or have prohibited new employees from entering the plan entirely. The employers may then have allowed employees who had already begun participation in the defined benefit plan (or who are older or have been credited with longer service under the plan) to continue to earn pension benefits under the defined benefit plan while closing the plan or formula to all other employees. These defined benefit plans are sometimes referred to as “closed plans,” and the employees who continue to earn pension benefits under the closed plan are often known as a “grandfathered group of employees.” In situations in which new employees continue to earn benefits under the defined benefit plan, but are under a new formula, any formula that continues to apply to a grandfathered group of employees is sometimes referred to as a “closed formula.”

Closed plans are required to meet the coverage rules under section 410(b) and the nondiscrimination rules under section 401(a)(4) (including a nondiscrimination requirement regarding the availability of benefits, rights, and features). Many closed plans, however, may eventually find it difficult to meet these requirements because the proportion of the grandfathered group of employees who are highly compensated employees compared to the employer’s

total workforce increases over time. This occurs because members of the grandfathered group of employees usually continue to receive pay raises (and so may become highly compensated employees), and new employees (who are generally nonhighly compensated employees) are not covered by the closed plan.

When a closed defined benefit plan can no longer meet the nondiscrimination requirements on a stand-alone basis because of the demographic changes previously described, it can demonstrate compliance with section 401(a)(4) by aggregating with the employer's defined contribution plan. In general, it is easier to meet the nondiscrimination requirements if the resulting DB/DC plan demonstrates compliance with section 401(a)(4) based on the benefits or equivalent benefits provided to the employees (rather than based on contributions).

On January 6, 2014, the Treasury Department and the IRS published Notice 2014-5, 2014-2 I.R.B. 276. Notice 2014-5 provided temporary nondiscrimination relief for certain closed plans. Specifically, under Notice 2014-5, if certain criteria are satisfied,<sup>4</sup> a plan sponsor is permitted to test a DB/DC plan that includes a closed plan that was closed before December 13, 2013, on a benefits basis for plan years beginning before January 1, 2016, without complying with the minimum aggregate allocation gateway, even if that

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<sup>4</sup> Generally, in order to be eligible for the relief provided by Notice 2014-5, each defined benefit plan that is part of an aggregated DB/DC plan must have satisfied the requirements of section 401(a)(4) without using the minimum aggregate allocation gateway under §1.401(a)(4)-9(b)(2)(v)(D). Thus, the defined benefit plan must have either been primarily defined benefit in character (within the meaning of §1.401(a)(4)-9(b)(2)(v)(B)), consisted of broadly available separate plans (within the meaning of §1.401(a)(4)-9(b)(2)(v)(C)), or satisfied the applicable nondiscrimination rules without being aggregated with a DC plan.

would otherwise be required under the current regulations. Notice 2015-28, 2015-14 I.R.B. 848, extended that relief for an additional year by applying it to plan years beginning before 2017 provided that the conditions of Notice 2014-5 are satisfied.

Notice 2014-5 also requested comments on whether the section 401(a)(4) regulations should be amended to provide additional alternatives that would allow a DB/DC plan to satisfy the nondiscrimination in amount requirements on the basis of equivalent benefits, and whether certain other permanent changes should be made to the nondiscrimination regulations, such as modifications to the rules regarding nondiscriminatory benefits, rights, and features.<sup>5</sup> The comments received in response to Notice 2014-5 generally supported these types of changes. In addition, all of the commenters requested permanent changes to the nondiscrimination requirements in order to make it easier for closed plans to continue to satisfy the nondiscrimination requirements.

The Treasury Department and the IRS agree that permanent changes to the nondiscrimination rules should be made in order to help employers and plan sponsors preserve the retirement expectations of certain grandfathered groups of employees. These changes are meant to apply to situations in which the proportion of the grandfathered group of employees who are highly compensated

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<sup>5</sup> Section 1.401(a)(4)-4 provides rules for determining whether the benefits, right, and features provided under a plan are made available in a nondiscriminatory manner. Under these rules, each benefit, right, or feature must satisfy the current availability requirement of §1.401(a)(4)-4(b) (which requires testing of the group to which the benefit, right, or feature is currently available) and the effective availability requirement of §1.401(a)(4)-4(c) (which requires that the group of employees to whom the benefit, right, or feature is effectively available must not substantially favor highly compensated employees).

employees compared to the employer's total workforce has increased due to ordinary demographic changes, as previously described in this preamble.

## **Explanation of Provisions**

### **I. Overview**

The proposed regulations modify a number of provisions in the existing regulations under section 401(a)(4) to address situations and plan designs, including closed plans and formulas, that were not contemplated in the development of the regulations and the 2001 amendments. While many of the changes in the proposed regulations provide nondiscrimination relief for certain closed plans and formulas, the proposed regulations also include other changes that are not limited to closed plans and formulas.

### **II. Rules related to closed plans and similar arrangements**

The proposed regulations set forth special rules that allow closed plans and similar arrangements to satisfy the nondiscrimination rules in additional situations. These special rules are based on the existing rules for DBRAs, as modified to respond to concerns raised by stakeholders with respect to those existing rules.

Under the proposed regulations, the eligibility conditions set forth in the modified DBRA rules (described in section II.A of this portion of the preamble) provide a framework for the eligibility conditions for the snapshot rule related to closed plans in a DB/DC plan (described in section II.B of this portion of the preamble). The modified DBRA rules are also used as a basis for the special testing rule for benefits, rights, and features provided to a grandfathered group of



employees (described in section II.C of this portion of the preamble). For example, the special testing rule for a benefit, right, or feature provided to a grandfathered group of employees under a defined contribution plan establishes nondiscrimination relief for matching contributions provided to a grandfathered group of employees who formerly participated in a defined benefit plan that is intended to be consistent with the nondiscrimination relief provided by the modified DBRA rules for nonelective contributions provided to such a grandfathered group of employees.

**A. Modifications to the DBRA rules under §1.401(a)(4)-8**

The proposed regulations modify the rules applicable to DBRAs under §1.401(a)(4)-8, which allow certain defined contribution plan allocations to be disregarded when determining whether a defined contribution plan has broadly available allocation rates. The rules applicable to DBRAs allow employers to provide, in a nondiscriminatory manner, certain allocations to replace defined benefit plan retirement benefits without having to satisfy the minimum aggregate allocation gateway. The modifications in the proposed regulations are intended to allow more allocations to fit within the DBRA rules. For example, under the existing regulations a DBRA must be reasonably designed to replace the benefits that would have been provided under the closed defined benefit plan. The proposed regulations provide greater flexibility in this respect and allow the allocations to be reasonably designed to replace some or all of the benefits that would have been provided under the closed plan, subject to a requirement that

the allocations be provided in a consistent manner to all similarly situated employees.

The proposed regulations incorporate a modified version of the conditions for an allocation to be a DBRA that were reflected in Rev. Rul. 2001-30, 2001-2 C.B. 46. For example, under one of the conditions set forth in Rev. Rul. 2001-30, in order for an allocation to be a DBRA, the defined benefit plan's benefit formula for the group of employees who formerly benefitted under that plan must have generated equivalent normal allocation rates that increased from year to year as employees attained higher ages. The proposed regulations ease this restriction on the types of defined benefit plans with respect to which a DBRA can be provided by allowing a DBRA also to replace the benefit provided under a defined benefit plan with a benefit formula that generated equivalent normal allocation rates that increased from year to year as employees were credited with additional years of service (rather than only as the employees attained higher ages).

The existing regulation also requires that the group of employees who receive a DBRA must be a nondiscriminatory group of employees, and Rev. Rul. 2001-30 interprets this rule as requiring that the group of employees satisfy the minimum coverage requirements of section 410(b) (determined without regard to the average benefit percentage test). The proposed regulations incorporate this interpretation, but limit its application so that the rule only applies for the first 5 years after the closure date. In addition, the proposed regulations incorporate the interpretation in Rev. Rul. 2001-30 regarding whether the defined benefit plan

was an established nondiscriminatory defined benefit plan by requiring that the closed plan be in effect for 5 years before the closure date (with one year substituted for 5 years, as provided by Rev. Rul. 2001-30, in the case of a defined benefit plan maintained by a former employer) with no substantial change to the closed plan during that time (except for certain permitted amendments allowed by the proposed regulations).

In addition, the proposed regulations expand the list of permitted amendments to a closed plan that do not prevent allocations under a plan from being DBRAs. For example, the proposed regulations permit an amendment to a closed plan during the 5-year period before it was closed, provided that the amendment does not increase the accrued benefit or future accruals for any employee, does not expand coverage, and does not reduce the ratio-percentage under any applicable nondiscrimination test. In addition, under the proposed regulations, an amendment during this period could extend coverage to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

As under the existing regulations, the proposed regulations contain a general restriction on plan amendments relating to a DBRA; however, the proposed regulations expand the list of plan amendments that are excepted from this rule. The proposed regulations retain the exception from this restriction on plan amendments for an amendment that makes de minimis changes in the calculation of a DBRA and for an amendment that adds or removes a “greater-of” plan provision (under which a participant receives the greater of the otherwise

applicable allocation and the DBRA). In addition, the proposed regulations provide an exception from this restriction for any plan amendment modifying a DBRA that does not reduce the ratio percentage under any applicable nondiscrimination test.

**B. Closed plan rule added to the plan aggregation and restructuring rules under §1.401(a)(4)-9**

The proposed regulations add a new exception to the requirement that a DB/DC plan must satisfy the minimum aggregate allocation gateway once the other conditions under §1.401(a)(4)-9 are not met (the “closed plan rule”). This closed plan rule, which applies to a DB/DC plan that includes a closed plan, provides an exception to the minimum aggregate allocation gateway that would otherwise apply, but only if the closed plan was in effect for 5 years before the closure date and no significant change was made to the closed plan during or since that time (except for certain permitted amendments).

The DB/DC plan may use this closed plan rule for a plan year that begins on or after the fifth anniversary of the closure date. To be eligible for the closed plan rule, during the 5-year period following the closure date, either the DB/DC plan must satisfy the nondiscrimination in amount requirement of section 401(a)(4) without using the minimum aggregate allocation gateway, or the closed plan must satisfy that requirement without aggregation with any defined contribution plan. This requirement is comparable to the requirement that the group of employees who receive DBRAs must be a group of employees who satisfy the minimum coverage requirements of section 410(b).

Under the proposed regulations, certain amendments to a closed defined benefit plan do not prevent the plan from using the closed plan rule. These plan amendments are intended to allow a plan sponsor of a closed plan to address changed circumstances. For example, under the proposed regulations, a plan amendment during the 5-year period ending on the closure date does not prevent the plan from later using the closed plan rule, provided that the plan amendment does not increase the accrued benefit or future accruals for any employee, does not expand coverage, and does not reduce the ratio percentage under any applicable nondiscrimination test. Similarly, an amendment to the closed plan is permitted after the closure date, provided that the amendment does not reduce the ratio percentage under any applicable nondiscrimination test. Thus, for example, under the proposed regulations, a plan sponsor may add nonhighly compensated employees to a coverage group after it is closed in order to satisfy the nondiscrimination rules. De minimis changes to the closed plan's benefit formula are also permitted under the proposed regulations.

**C. Special testing rule for the nondiscriminatory availability of a benefit, right, or feature provided to a grandfathered group of employees under §1.401(a)(4)-4**

The proposed regulations establish a special nondiscrimination testing rule under §1.401(a)(4)-4 that applies if a benefit, right, or feature is made available only to a grandfathered group of employees with respect to a closed plan. This special rule provides relief in certain circumstances from certain nondiscrimination testing for a benefit, right, or feature provided under the closed

plan, or for a rate of matching contributions provided to a grandfathered group under a defined contribution plan.

If the eligibility conditions are satisfied, the special testing rule treats a benefit, right, or feature that is provided only to a grandfathered group of employees as satisfying the current and effective availability tests of §1.401(a)(4)-4(b) and (c). The special testing rule applies to plan years beginning on or after the fifth anniversary of the closure date and applies on a plan-year by plan-year basis. To be eligible for the special testing rule, the benefit, right or feature must be currently available to a group of employees that satisfies the minimum coverage requirements of section 410(b) for the plan years that begin within 5 years after the closure date. Once the special testing rule applies to a benefit, right, or feature, the special testing rule continues to apply for purposes of that benefit, right, or feature indefinitely (unless a later amendment changes the eligibility for the benefit, right, or feature). If a plan amendment changes the eligibility for the benefit, right, or feature after the closure date, then the special testing rule will cease to apply (subject to certain specified exceptions).

If the benefit, right, or feature that is available solely to a grandfathered group of employees is provided under a defined benefit plan, then it must be provided under the closed plan (rather than a different defined benefit plan). This is because the purpose of the special rule is to accommodate a plan amendment under which the benefit formula has been changed, but the prior benefit formula has been preserved for a grandfathered group of employees and the benefit,

right, or feature is made available only to the grandfathered group of employees who continue to accrue benefits under the prior benefit formula.<sup>6</sup> Accordingly, the special testing rule is available only if the amendment restricting the availability of the benefit, right, or feature also resulted in a significant change in the type of the defined benefit plan's formula. For example, a conversion to a cash balance plan would be a significant change in the type of benefit formula, so that the special testing rule would apply to facilitate preservation of any subsidized early retirement factors for the employees who continue to benefit under the prior benefit formula. By contrast, in the case of a benefit formula that determines benefits as a percentage of compensation, a change in that formula to reduce that percentage would not be considered a significant change in the type of benefit formula, even if the reduction is large.

The special testing rule for a benefit, right, or feature provided under the closed plan also requires that the benefit, right, or feature has been in effect without being amended for a 5-year period before the closure date (subject to a limited exception for acquired employees). This rule is designed to ensure that the special treatment is available only for a long-standing provision and cannot be used for a benefit, right, or feature that has not been provided long enough for participants to have established a reasonable expectation that it will continue. In addition, this rule prevents a plan sponsor from obtaining special treatment for a benefit, right, or feature added shortly before and in anticipation of the closure of

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<sup>6</sup> The existing regulations provide a special rule for current availability testing for a benefit, right, or feature that applies solely to benefits accrued before the amendment date. See §1.401(a)(4)-4(d)(2).

the plan. The proposed regulations set forth a list of permitted plan amendments that do not result in the loss of this special testing rule that are generally comparable to the list of permitted amendments for other closed plan arrangements.

The special testing rule also applies to a rate of matching contributions under a defined contribution plan that meets certain requirements. In order to be eligible for this testing rule, the rate of matching contributions must be reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that each employee in the grandfathered group of employees would have been provided under the closed plan in the absence of a closure amendment. In addition, the rate of matching contributions for the grandfathered group of employees must be provided in a consistent manner to all similarly situated employees.

### **III. Modification of testing options under §1.401(a)(4)-9 for DB/DC plans, including DB/DC plans that do not include a closed plan**

In addition to providing a special rule for closed plans and similar arrangements, the proposed regulations generally ease the rules under which any DB/DC plan can satisfy the nondiscrimination in amount requirement on the basis of benefits. These changes are intended to facilitate the ongoing maintenance of a defined benefit plan that provides coverage to a group of employees that is determined using a reasonable business classification.

The proposed regulations expand the ability to use the average of the equivalent allocation rates under the defined benefit plan for purposes of satisfying the minimum aggregate allocation gateway by permitting the averaging



of allocation rates for nonhighly compensated employees under the defined contribution plan for this purpose. This modification is intended to better accommodate plan sponsors that have a defined contribution plan with service- or age-based allocation formulas. The Treasury Department and the IRS have determined that it is appropriate, in this context, to allow shorter-service nonhighly compensated employees to be provided less than the minimum aggregate allocation gateway rate, as long as longer-service nonhighly compensated employees are provided allocation rates that are sufficiently higher than the minimum aggregate allocation gateway rate. The Treasury Department and the IRS are considering whether any restrictions on this rule are appropriate so that the rule serves its intended purpose of facilitating formulas that provide higher allocation rates to longer-service nonhighly compensated employees, and invite comments on ways to permit appropriate flexibility while ensuring the provision is not used to circumvent the purpose of the nondiscrimination rules.

The proposed regulations also include a limitation on the averaging of rates that applies to both defined contribution and defined benefit plans in order to minimize the impact of outliers. In general, this special rule applies a cap under which any equivalent normal allocation rate or allocation rate in excess of 15% is treated as equal to 15%. However, this cap is raised to 25% for any allocation rate or equivalent normal allocation rate that results solely from a plan design providing allocation rates or generating equivalent normal allocation rates that are a function of age or service under which higher rates are provided to older or longer-service employees.

In addition, under the proposed regulations, the average of the matching contributions actually made for nonhighly compensated employees may be used to a limited extent (up to 3 percent of compensation) for purposes of determining whether each nonhighly compensated employee satisfies the minimum aggregate allocation gateway test. Thus, for example, if the minimum aggregate allocation gateway is 7% and the average of the matching contributions actually made for nonhighly compensated employees is 3%, then a non-elective contribution of 4% for each individual would be needed in order to satisfy the minimum aggregate allocation gateway under the proposed regulations. The regulations use the average matching contributions, rather than matching contributions allocated for each employee, in order to avoid diluting the incentive effect of an employer match.

The proposed regulations also provide a new alternative to the minimum aggregate allocation gateway. Under this alternative, a DB/DC plan is not required to satisfy the minimum aggregate allocation gateway if it can satisfy the nondiscrimination in amount requirement on the basis of equivalent benefits using an interest rate of 6%, rather than the current standard interest rate of between 7.5% and 8.5%.

#### **IV. Benefit formulas for individual employees or groups without a reasonable business purpose; modifications to the amounts testing rules under §1.401(a)(4)-2 and §1.401(a)(4)-3**

The proposed regulations also include changes to address certain arrangements that take advantage of the flexibility in the existing

nondiscrimination rules<sup>7</sup> to provide a special benefit formula for selected employees without extending that formula to a classification of employees that is reasonable and is established under objective business criteria. A plan satisfies the minimum coverage requirements of section 410(b) if the plan's ratio percentage is 70% or higher or the plan satisfies the average benefit test. To satisfy the average benefit test, pursuant to §1.410(b)-4, the group of employees must be determined using a classification that is reasonable and that is established under objective business criteria pursuant to §1.410(b)-4(b) and must have a ratio percentage that is described in §1.410(b)-4(c) (which includes safe harbor and unsafe harbor percentages). A classification of employees that is reasonable and is established under objective business criteria is referred to in this preamble as a "reasonable business classification." To the extent that a plan provides a special benefit formula and can still pass the nondiscrimination requirements, the plan sponsor can use a qualified retirement plan to provide benefits that would otherwise be provided under a nonqualified plan. These arrangements are sometimes referred to as qualified supplemental executive retirement plans (or QSERPs).

Under the general test in the existing regulations, if a plan satisfies the minimum coverage requirements of section 410(b) using the average benefit percentage test, then the rate group for each highly compensated employee is

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<sup>7</sup> Under the existing regulations, the nondiscrimination requirements of section 401(a)(4) and the coverage rules of section 410(b) are coordinated. The general test under the section 401(a)(4) regulations is applied by determining whether each rate group under the plan (that is, for each highly compensated employee, the group of employees with a benefit or contribution rate that is greater than or equal to the benefit or contribution rate for the highly compensated employee) satisfies section 410(b) as if it were a plan.

treated as satisfying the minimum coverage requirements if the ratio percentage for the rate group is equal to the midpoint between the safe harbor and the unsafe harbor percentages (or the ratio percentage for the plan as a whole, if less). This rule recognizes that the composition of a rate group may be unpredictable and so the rate group should not be subject to a reasonable business classification standard. However, that same consideration is not relevant if the group of employees to whom the allocation formula under a defined contribution plan (or benefit formula under a defined benefit plan) applies is not a reasonable business classification.

Accordingly, the proposed regulations limit the existing rule under which a rate group with respect to a highly compensated employee is treated as satisfying the average benefit percentage test to those situations in which the allocation formula (or benefit formula) that applies to the highly compensated employee also applies to a reasonable business classification. For example, if a benefit formula applies solely to a highly compensated employee who is identified by name, it does not apply to a reasonable business classification. See §1.410(b)-4(b). In such a case, the proposed regulations would require that the rate group with respect to that individual satisfy the ratio percentage test.

#### **Proposed Applicability Date**

Except as described below, these regulations are proposed to be applicable to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers are permitted to apply the provisions of these proposed

regulations except for those described in section III of the Explanation of Provisions portion of the preamble for plan years beginning before this proposed applicability date, but not for plan years earlier than those beginning on or after January 1, 2014. Accordingly, the ability to rely on a provision of these proposed regulations for periods prior to the proposed applicability date for these regulations applies to the disregard of certain defined benefit replacement allocations in cross-testing; the exception from the minimum aggregate allocation gateway with respect to certain closed plans; the special testing rule for benefits, rights, and features with respect to certain closed plans; and the rule applying the ratio percentage test to a rate group in the case of a benefit formula that does not apply to a reasonable business classification. Taxpayers may rely on these provisions (that is, the provisions that the proposed regulations would permit a taxpayer to apply before the proposed applicability date for these regulations) in order to satisfy the nondiscrimination requirements of section 401(a)(4) for plan years beginning on or after January 1, 2014, and until the corresponding final regulations become applicable.

### **Special Analyses**

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small

entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "ADDRESSES" heading. Treasury and the IRS request comments on all aspects of the proposed rules, including the proposed applicability date. Treasury and the IRS also request comments on the following issues:

- Whether guidance needs to be developed for a plan that has more than one closure or closure amendment?
- Whether the rules regarding transition allocations and successor employers are still needed in light of the modifications to the DBRA rules?

All comments will be available for public inspection and copying at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing has been scheduled for May 19, 2016, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington D.C. Because of building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Due to access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes

before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** and an outline of the topics to be discussed and the time to be devoted to each topic by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. A signed paper or electronic copy of the outline should be submitted as prescribed in this preamble under the "ADDRESSES" heading. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### **Statement of Availability for IRS Documents**

For copies of recently issued Revenue Procedures, Revenue Rulings, notices, and other guidance published in the Internal Revenue Bulletin, please visit the IRS website at <http://irs.gov>.

#### **Drafting Information**

The principal authors of these proposed regulations are Kelly C. Scanlon and Linda S. F. Marshall, IRS Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the

Department of Treasury participated in the development of the proposed regulations.

## **List of Subjects in 26 CFR Part 1**

Income taxes, reporting and recordkeeping requirements.

## **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.401(a)(4)-0 is amended by:

1. Adding paragraph (c)(5) to the entry for § 1.401(a)(4)-2.
2. Adding paragraph (d)(8) to the entry for § 1.401(a)(4)-4.
3. Adding paragraph (a)(4) to the entry for § 1.401(a)(4)-13.

The additions read as follows:

§ 1.401(a)(4)-0 Table of contents.

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*§ 1.401(a)(4)-2 Nondiscrimination in amount of employer contributions under a defined contribution plan.*

\* \* \* \* \*

(c) \* \* \*

(5) Effective/applicability date.



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§ 1.401(a)(4)-4 *Nondiscriminatory availability of benefits, rights, and features*

\* \* \* \* \*

(d) \* \* \*

(8) Special testing rule for grandfathered group of employees.

\* \* \* \* \*

§ 1.401(a)(4)-13 *Effective dates and fresh-start rules.*

(a) \* \* \*

(4) Effective/applicability date.

\* \* \* \* \*

Par. 3. Section 1.401(a)(4)-2 is amended by:

1. Revising paragraph (c)(3)(ii).
2. Revising Examples 4 and 5 in paragraph (c)(4).
3. Adding Examples 6 and 7 to paragraph (c)(4).
4. Adding paragraph (c)(5).

The revisions and additions read as follows:

§1.401(a)(4)-2 Nondiscrimination in amount of employer contributions under a defined contribution plan.

\* \* \* \* \*

(c) \* \* \*

(3) \* \* \*

(ii) Application of nondiscriminatory classification test. A rate group satisfies the nondiscriminatory classification test of §1.410(b)-4 if and only if--

(A) The formula that is used to determine the allocation for the HCE with respect to whom the rate group is established applies to a group of employees that satisfies the reasonable classification requirement of §1.410(b)-4(b); and

(B) The ratio percentage of the rate group is greater than or equal to the midpoint between the safe and unsafe harbor percentages applicable to the plan (or the ratio percentage of the plan, if that percentage is less).

\* \* \* \* \*

(4) \* \* \*

Example 4. (a) The facts are the same as in Example 3, except that N4 has an allocation rate of 8.0 percent. In addition, the formula that is used to determine the allocation for H2 is the same formula that is used to determine the allocation for all other employees in Plan D.

(b) There are two rate groups in Plan D. Rate group 1 consists of H1 and all those employees who have an allocation rate greater than or equal to H1's allocation rate (5.0 percent). Thus, rate group 1 consists of H1, H2 and N1 through N4. Rate group 2 consists of H2, and all those employees who have an allocation rate greater than or equal to H2's allocation rate (7.5 percent). Thus, rate group 2 consists of H2 and N4.

(c) Rate group 1 satisfies the ratio percentage test under §1.410(b)-2(b)(2) because the ratio percentage of the rate group is 100 percent--that is, 100 percent (the percentage of all nonhighly compensated nonexcludable employees who are in the rate group) divided by 100 percent (the percentage of all highly compensated nonexcludable employees who are in the rate group).

(d) Rate group 2 does not satisfy the ratio percentage test of §1.410(b)-2(b)(2) because the ratio percentage of the rate group is 50 percent--that is, 25 percent (the percentage of all nonhighly compensated nonexcludable employees who are in the rate group) divided by 50 percent (the percentage of all highly compensated nonexcludable employees who are in the rate group).

(e) However, under paragraph (c)(3)(ii) of this section rate group 2 satisfies the nondiscriminatory classification test of §1.410(b)-4 because (i) the formula that is used to determine the allocation for H2 applies to a group of employees that satisfies the reasonable classification requirement of §1.410(b)-4(b) (in this case, because it applies to all the employees) and (ii) the ratio percentage of the rate group (50 percent) is greater than the midpoint between the safe harbor and unsafe harbor percentages applicable to the plan under §1.410(b)-4(c)(4) (40.5 percent).

(f) Under paragraph (c)(3)(iii) of this section, rate group 2 satisfies the average benefit percentage test if Plan D satisfies the average benefit percentage test. (The requirement that Plan D satisfy the average benefit percentage test applies even though Plan D satisfies the ratio percentage test and would ordinarily not need to run the average benefit percentage test.) If Plan D satisfies the average benefit percentage test, then rate group 2 satisfies section 410(b); thus, Plan D satisfies the general test in paragraph (c)(1) of this section because each rate group under the plan satisfies section 410(b).

**Example 5.** (a) Plan E satisfies section 410(b) by satisfying the nondiscriminatory classification test of §1.410(b)-4 and the average benefit percentage test of §1.410(b)-5 (without regard to §1.410(b)-5(f)). See §1.410(b)-2(b)(3). Plan E uses the facts-and-circumstances requirements of §1.410(b)-4(c)(3) to satisfy the nondiscriminatory classification test of §1.410(b)-4. The safe and unsafe harbor percentages applicable to the plan under §1.410(b)-4(c)(4) are 29 and 20 percent, respectively. Plan E has a ratio percentage of 22 percent. Rate group 1 under Plan E has a ratio percentage of 23 percent. The

formula that is used to determine the allocation for the HCE with respect to whom rate group 1 was formed applies to all other employees

(b) Under paragraph (c)(3)(ii) of this section, rate group 1 satisfies the nondiscriminatory classification requirement of §1.410(b)-4, because (i) the formula that is used to determine the allocation for the HCE with respect to whom the rate group was formed applies to a group of employees that satisfies the reasonable classification requirement of §1.410(b)-4(b) (in this case, because it applies to all the employees) and (ii) the ratio percentage of the rate group (23 percent) is greater than the lesser of--

(1) The ratio percentage for the plan as a whole (22 percent); and

(2) The midpoint between the safe and unsafe harbor percentages (24.5 percent).

(c) Under paragraph (c)(3)(iii) of this section, the rate group satisfies section 410(b) because the plan satisfies the average benefit percentage test of §1.410(b)-5.

Example 6. (a) Employer Z maintains a defined contribution plan, Plan F. Employer Z has six nonexcludable employees, all of whom benefit under Plan F. There is one HCE (H1) and five NHCEs (N1 through N5). There is one rate group under Plan F. The formula that is used to determine the allocation for H1 is the greater of \$20,000 or 10% of compensation for the year. The formula that applies to determine the allocation for N1 through N5 is 10% of compensation.

(b) Under paragraph (c)(3)(ii) of this section, the rate group with respect to H1 does not satisfy the nondiscriminatory classification test under §1.410(b)-4 because the formula that is used to determine the allocation for H1 (with respect to whom the rate group is established) only applies to H1. Therefore, the rate group will satisfy paragraph (c)(3) of this section only if the ratio percentage of the rate group is greater than or equal to 70 percent. This ratio percentage test applies even if H1's compensation is greater than \$200,000. In such a case, the rate group will pass the ratio percentage test (and accordingly the plan will satisfy the general test of this paragraph (c)) because each employee receives an allocation of 10% of compensation and therefore the ratio percentage for the rate group is equal to 100%.

Example 7. The facts are the same as in Example 6, except that the classification of employees who are entitled to benefit under the formula that applies to H1 includes N1 and N2, who are identified by name. Under paragraph (c)(3)(ii) of this section, the rate group with respect to H1 does not satisfy the nondiscriminatory classification test under §1.410(b)-4 because the classification of H1, N1 and N2 by name does not satisfy the reasonable classification requirement of §1.410(b)-4(b). Therefore, the rate group with respect to H1 will

satisfy paragraph (c)(3) of this section only if the ratio percentage of the rate group is greater than or equal to 70 percent.

(5) Effective/applicability date. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this paragraph (c).

Par. 4. In §1.401(a)(4)-3, paragraph (c)(2) is revised to read as follows:

§1.401(a)(4)-3 Nondiscrimination in amount of employer-provided benefits under a defined benefit plan.

\* \* \* \* \*

(c) \* \* \*

(2) Satisfaction of section 410(b) by a rate group. For purposes of determining whether a rate group satisfies section 410(b), the rules of §1.401(a)(4)-2(c)(3) apply except that §1.401(a)(4)-2(c)(3)(ii)(A) is applied by substituting “benefit formula” for “formula that is used to determine the allocation.” See paragraph (c)(4) of this section and §1.401(a)(4)-2(c)(4), Example 3 through Example 6, for examples of this rule. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this paragraph (c)(2).

\* \* \* \* \*

Par. 5. In §1.401(a)(4)-4, paragraph (d)(8) is added to read as follows:

§1.401(a)(4)-4 Nondiscriminatory availability of benefits, rights, and features.

\* \* \* \* \*

(d) \* \* \*

(8) Special testing rule for grandfathered group of employees--(i) General rule. For a plan year that begins on or after the fifth anniversary of the closure date with respect to a closed defined benefit plan, a benefit, right, or feature under a defined benefit or defined contribution plan that is available only to a grandfathered group of employees with respect to the closed defined benefit plan is treated as satisfying paragraphs (b) and (c) of this section for the plan year, provided that--

(A) No plan amendment that affects the availability of the benefit, right, or feature (other than the closure amendment) has an applicable amendment date (within the meaning of §1.411(d)-3(g)(4)) that is within the period that begins on the closure date and ends on the last day of the plan year; and

(B) The additional requirements of paragraph (d)(8)(ii) or (iii) of this section, whichever is applicable, are satisfied.

(ii) Additional requirements in the case of a benefit, right, or feature provided under a defined benefit plan. If the benefit, right, or feature is provided under a defined benefit plan, then the following additional requirements apply--

(A) The defined benefit plan under which the benefit, right, or feature is provided is the closed defined benefit plan;

(B) No plan amendment that affects the availability of the benefit, right, or feature (other than the closure amendment) has an applicable amendment date that is within the 5-year period ending on the closure date; and

(C) The closure amendment that restricted the availability of the benefit, right, or feature, making it available only to the grandfathered group of employees, must also have provided for a significant change in the type of benefit formula under the plan (such as a change from a benefit formula that is not a statutory hybrid benefit formula to a lump sum-based benefit formula).

(iii) Additional requirements in the case of a benefit, right, or feature provided under a defined contribution plan. If the benefit, right, or feature is provided under a defined contribution plan, then the following additional requirements apply--

(A) The benefit, right, or feature must be a right to a rate of matching contributions provided under the defined contribution plan;

(B) The rate of matching contributions must be reasonably designed so that the matching contributions will replace some or all of the value of the benefit accruals that each employee in the grandfathered group of employees would have been provided under the closed defined benefit plan in the absence of a closure amendment (based on the terms of that plan and the section 415(b)(1)(A) dollar limit in effect immediately prior to the closure date);

(C) The closed defined benefit plan must satisfy the conditions set forth in §1.401(a)(4)-8(b)(1)(iii)(D)(3); and



(D) The rate of matching contributions must be provided in a consistent manner to all similarly situated employees.

(iv) Certain amendments not taken into account. For purposes of applying the rules under this paragraph (d)(8), the following plan amendments are not taken into account (and, in the case of an amendment described in paragraph (d)(8)(iv)(C) or (D) of this section, the rules of this paragraph (d)(8) are applied as if the benefit, right, or feature provided after the amendment were the benefit, right, or feature provided before the amendment):

(A) An amendment adopted during the 5-year period ending on the closure date that extends eligibility for the benefit, right, or feature to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

(B) An amendment adopted after the closure date that expands or restricts the eligibility for the benefit, right, or feature, provided that, as of the applicable amendment date, the ratio percentage of the group of employees eligible for the benefit, right, or feature (taking into account the plan amendment) is not less than the ratio percentage of the group of employees eligible for the benefit, right, or feature provided before the amendment.

(C) An amendment adopted after the closure date that results in a replacement of the benefit, right, or feature with another benefit, right, or feature that is available to the same group of employees as the original benefit, right, or feature, provided that the original benefit, right, or feature is of inherently equal or

greater value (within the meaning of paragraph (d)(4)(i)(A) of this section) than the benefit, right, or feature that replaces it.

(D) An amendment adopted after the closure date that results in a replacement of the benefit, right, or feature with another benefit, right, or feature that is available to the same group of employees as the original benefit, right, or feature, provided that there is only a de minimis difference between the amount payable under the original benefit, right, or feature and the amount payable under the benefit, right, or feature that replaces it.

(E) An amendment that is permitted by guidance published by the Commissioner in the Internal Revenue Bulletin.

(v) Examples. The following examples illustrate the rules in this paragraph (d)(8):

Example 1--(i) Pre-amendment defined benefit plan. Employer A maintains Plan P, a defined benefit plan that provides for an annual benefit equal to 2% of an employee's average annual compensation multiplied by the employee's years of service. Plan P also provides for a subsidized early retirement benefit available to employees who retire between the ages of 55 and 65 with 20 years of service. Plan P was established in 2003. The plan year is a calendar year. For the 2015 plan year, Plan P satisfied the nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregation with any other plan.

(ii) Plan conversion amendment. On November 1, 2015, Employer A amends Plan P to cease future accruals under its benefit formula effective as of the close of the plan year ending December 31, 2015 and to provide future benefit accruals under a cash balance formula. The cash balance formula provides for pay credits equal to 5% of compensation and annual interest credits at an interest crediting rate of 6%. Early retirement benefits payable with respect to benefits accrued under the cash balance formula are determined as the actuarial equivalent of the hypothetical account balance, determined using reasonable actuarial assumptions that are specified in Plan P. Under the terms of the conversion amendment, an employee's benefit is equal to the employee's benefit under the prior benefit formula as of the close of the plan year ending December 31, 2015, plus the amount determined under the cash balance

formula. However, any employee who had attained the age of 50 and had completed 15 years of service on or before December 31, 2015 is entitled to a plan benefit that is the greater of the benefit determined under the pre-amendment formula, or the benefit described in the prior sentence. Except for the closure amendment, there is no other plan amendment that affects the availability of Plan P's early retirement subsidy. No other significant change to Plan P's coverage or benefit formula is made with an applicable amendment date that is during the period beginning on January 1, 2011 and ending on December 31, 2015 (the 5-year period ending on the closure date).

(iii) Applicability of special testing rule. The plan conversion amendment is a closure amendment with a closure date of December 31, 2015. Plan P's subsidized early retirement benefit available solely to the grandfathered group of employees is a separate benefit, right, or feature that must be tested for current and effective availability under paragraphs (b) and (c) of this section. For a plan year that begins on or after January 1, 2021, Plan P's subsidized early retirement benefit is eligible for the relief provided by the special testing rule of this paragraph (d)(8) because all of the applicable requirements are satisfied. The requirement under paragraph (d)(8)(i)(A) of this section is satisfied because no other plan amendment that affects the availability of the subsidized early retirement benefit has an applicable amendment date that is on or after December 31, 2015. The additional requirements pertaining to a benefit, right, or feature provided under a defined benefit plan are also satisfied: the subsidized early retirement benefit is provided under a closed defined benefit plan as required by paragraph (d)(8)(ii)(A) of this section; no amendment that affected the availability of the subsidized early retirement benefit was made with an applicable amendment date during the 5-year period ending on the closure date as required by paragraph (d)(8)(ii)(B) of this section; and Plan P has undergone a significant change in benefit formula in connection with the closure amendment that resulted in a restriction on the availability of the subsidized early retirement benefit as required by paragraph (d)(8)(ii)(C) of this section.

Example 2--(i) Closure of defined benefit plan. The facts are the same as in Example 1 of this paragraph (d)(8)(v), except that, instead of adopting a plan conversion amendment, Employer A amends Plan P to cease future accruals under the original benefit formula for all employees.

(ii) Plan amendment to profit-sharing plan that provides enhanced rate of matching contributions. Employer A has a profit-sharing plan that includes a qualified cash or deferred arrangement and matching contributions with respect to elective deferrals of up to 3% of compensation. On November 1, 2015, Employer A amends the plan to provide, effective January 1, 2016, for additional matching contributions of up to an additional 4% of compensation solely for employees who (1) were previously covered under the defined benefit plan, and (2) had attained the age of 50 and had 15 years of service on or before December 31, 2015. This enhanced rate of matching contributions is reasonably

designed so that the matching contributions will replace some or all of the value of the benefit accruals that would have otherwise been provided to this grandfathered group of employees under Plan P. Employer A makes no other change to this enhanced rate of matching contribution after the enhanced rate is established.

(iii) Applicability of special testing rule. The plan amendment is a closure amendment with a closure date of December 31, 2015. The enhanced rate of matching contribution that is available solely to the grandfathered group of employees is a separate benefit, right, or feature that must be tested for current and effective availability under paragraphs (b) and (c) of this section. For a plan year that begins on or after January 1, 2021, Plan P's enhanced rate of matching contribution is eligible for the relief provided by the special testing rule of this paragraph (d)(8) because all applicable requirements are satisfied. The requirement under paragraph (d)(8)(i)(A) of this section is satisfied because no change was made to the enhanced rate of match with an applicable amendment date that is on or after December 31, 2015. The following applicable additional requirements are also satisfied: the benefit, right, or feature provided under the defined contribution plan is a rate of matching contribution as required by paragraph (d)(8)(iii)(A) of this section; the enhanced rate of matching contribution is reasonably designed so that the matching contributions will replace some of the value of the benefit accruals that each employee in the grandfathered group of employees would have otherwise been provided under Plan P immediately prior to the closure date as required by paragraph (d)(8)(iii)(B) of this section; and the rate of matching contributions is provided in a consistent manner to all similarly situated employees as required by paragraph (d)(8)(iii)(D) of this section.

(iv) Applicability of §1.401(a)(4)-8(b)(1)(iii)(D)(3). In addition to the requirements described in paragraph (iii) of this Example 2, Plan P meets the conditions for a closed defined benefit plan specified in §1.401(a)(4)-8(b)(1)(iii)(D)(3) as required by paragraph (d)(8)(iii)(C) of this section because Plan P's prior benefit formula generated equivalent normal allocation rates that increased as employees attained higher ages; Plan P satisfied the minimum coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregating with any other plan for the plan year preceding the closure date; and Plan P was in effect for the five-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed during this period.

(vi) Effective/applicability dates. The rules of this paragraph (d)(8) apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final in the **Federal Register**. Taxpayers may apply the

rules of this paragraph (d)(8) for plan years beginning on or after January 1, 2014.

\* \* \* \* \*

Par. 6. Section 1.401(a)(4)-8 is amended by:

1. Revising paragraphs (b)(1)(iii)(B) through (E).
2. Removing paragraph (b)(1)(iii)(F).
3. Adding paragraph (b)(1)(iv)(E).

The revisions and additions read as follows:

§1.401(a)(4)-8 Cross-testing.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(B) Defined benefit replacement allocations disregarded. In determining whether a plan has broadly available allocation rates for the plan year within the meaning of paragraph (b)(1)(iii)(A) of this section, the following rules in paragraphs (b)(1)(iii)(B)(1) and (2) of this section apply:

(1) If an employee receives a defined benefit replacement allocation (within the meaning of paragraph (b)(1)(iii)(D) of this section) for the plan year in addition to the employee's otherwise applicable allocation under the plan for the plan year, then the employee's allocation rate is determined without regard to the defined benefit replacement allocation.

(2) If an employee receives an allocation for the plan year that is the greater of the allocation for which the employee would otherwise be eligible and the defined benefit replacement allocation (within the meaning of paragraph (b)(1)(iii)(D) of this section), then the allocation for which the employee would

otherwise be eligible is considered currently available to the employee, even if the employee's defined benefit replacement allocation is greater. See paragraph (b)(1)(iii)(C)(2) of this section for additional rules relating to "greater-of" plan provisions.

(C) Plan provisions--(1) In general. Plan provisions providing for defined benefit replacement allocations (within the meaning of paragraph (b)(1)(iii)(D) of this section) for the plan year must specify both the group of employees who are eligible for the defined benefit replacement allocations and the amount of the defined benefit replacement allocations.

(2) "Greater-of" plan provisions. An allocation does not fail to be a defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section merely because the plan provides that each employee who is eligible for a defined benefit replacement allocation receives the greater of that allocation and the allocation for which the employee would otherwise be eligible under the plan.

(3) Limited plan amendments. Except as provided in paragraph (b)(1)(iii)(D)(5) of this section, an allocation is not a defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section for the plan year if the plan provisions relating to the allocation are amended after the date those plan provisions are both adopted and effective.

(D) Defined benefit replacement allocation--(1) In general. A defined benefit replacement allocation is an allocation under a defined contribution plan provided only to a grandfathered group of employees with respect to a closed

defined benefit plan. An allocation is treated as a defined benefit replacement allocation if--

(i) The allocation satisfies the conditions to be a replacement allocation with respect to a closed defined benefit plan in paragraph (b)(1)(iii)(D)(2) of this section;

(ii) The closed defined benefit plan satisfies the conditions in paragraph (b)(1)(iii)(D)(3) of this section; and

(iii) For each plan year that begins before the fifth anniversary of the closure date of the closed defined benefit plan, the grandfathered group of employees is a nondiscriminatory group of employees within the meaning of paragraph (b)(1)(iii)(D)(4) of this section.

(2) Replacement allocation. An allocation is a replacement allocation with respect to a closed defined benefit plan under this paragraph (b)(1)(iii)(D)(2) if--

(i) The allocation is designed so that it is reasonably expected to replace some or all of the value of the benefit accruals that each employee in the grandfathered group of employees would have been provided under the closed defined benefit plan in the absence of a closure amendment (based on the terms of that plan and the section 415(b)(1)(A) dollar limit in effect immediately prior to the closure date); and

(ii) The allocation is provided in a consistent manner to all similarly situated employees.

(3) Closed defined benefit plan. A closed defined benefit plan satisfies the conditions in this paragraph (b)(1)(iii)(D)(3) if--



(i) The closed defined benefit plan's benefit formula applicable to the grandfathered group of employees generated equivalent normal allocation rates that increased from year to year as employees attained higher ages or were credited with additional years of service;

(ii) The closed defined benefit plan satisfied the minimum coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the special rules under section 410(b)(6)(C) and without aggregating with any other plan, for the plan year preceding the closure date; and

(iii) The closed defined benefit plan was in effect for the 5-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed by plan amendment with an effective date during this period.

(4) Nondiscriminatory group of employees. A group of employees is a nondiscriminatory group of employees for purposes of this paragraph (b)(1)(iii)(D)(4) if the group of employees satisfies section 410(b) for the plan year (without regard to §1.410(b)-5).

(5) Certain amendments not taken into account. For purposes of determining whether the requirements of paragraphs (b)(1)(iii)(C)(3) and (b)(1)(iii)(D)(3) of this section are satisfied, the following plan amendments are not taken into account:

(i) An amendment to the closed defined benefit plan adopted during the 5-year period ending on the closure date, provided that the accrued benefit or future accruals for any employee are not increased, coverage is not expanded,

and the amendment is not discriminatory within the meaning of paragraph (b)(1)(iii)(D)(6) of this section.

(ii) An amendment to the defined contribution plan under which the defined benefit replacement allocation is provided that makes de minimis changes in the calculation of that allocation (such as a change in the definition of compensation to include section 132(f) elective reductions).

(iii) An amendment to the defined contribution plan under which the defined benefit replacement allocation is provided that adds or removes a “greater-of” provision described under paragraph (b)(1)(iii)(C)(2) of this section.

(iv) An amendment to the defined contribution plan under which the defined benefit replacement allocation is provided that makes changes in the calculation of that allocation in a manner that is not discriminatory within the meaning of paragraph (b)(1)(iii)(D)(6) of this section.

(v) An amendment that guidance published by the Commissioner in the Internal Revenue Bulletin provides will not be taken into account.

(6) Nondiscriminatory amendment--(i) General rule. An amendment to a plan is not discriminatory if the ratio percentage of the plan is not decreased as a result of the amendment and, in the case of a plan that demonstrates compliance with the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) using a method other than a safe harbor test under §1.401(a)(4)-2(b), §1.401(a)(4)-3(b), or paragraph (b)(3) or (c)(3) of this section, the ratio percentage for the rate group with respect to any HCE is not decreased as a result of the amendment.

(ii) Timing of nondiscrimination testing. In determining whether the ratio percentage of the plan or the rate group is decreased as a result of an amendment, an amendment that is not in effect for an entire plan year is treated as if it were in effect for the entire plan year. In the case of an amendment that has separate portions with separate effective dates, each portion of the amendment is treated as a separate amendment that must satisfy the requirements of paragraph (b)(1)(iii)(D)(6)(i) of this section for the plan year in which it takes effect.

(7) Special rules for former employers and acquired employees. The following special rules apply in the case of former employers and acquired employees:

(i) If the closed defined benefit plan was sponsored by a former employer and not by the employer, then the rules in paragraph (b)(1)(iii)(D)(3)(ii) of this section do not apply and one year is substituted for 5 years with respect to paragraph (b)(1)(iii)(D)(3)(iii) of this section;

(ii) An amendment adopted during the 5-year period ending on the closure date that extends the coverage or benefit formula of the closed defined benefit plan to an acquired group of employees may be applied (in addition to the amendments described in paragraph (b)(1)(iii)(D)(5) of this section) provided that all similarly situated employees within that group are treated in a consistent manner; and

(iii) If the employees of a former employer become the employees of the new employer as a result of a transaction that is a merger, acquisition, or similar

event, then the transaction is treated as a closure amendment with respect to the former employer's plan as of the effective date of the acquisition.

(E) Effective/applicability date. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this section.

(iv) \* \* \*

(E) Defined benefit replacement allocation may be disregarded. In determining whether a plan has a gradual age or service schedule for the plan year within the meaning of paragraph (b)(1)(iv)(A) of this section, if an employee receives a defined benefit replacement allocation (within the meaning of paragraph (b)(1)(iii)(D) of this section) for the plan year, then the plan's schedule is determined without regard to the defined benefit replacement allocation. For this purpose, the rules under paragraph (b)(1)(iii)(B) of this section apply. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this paragraph (b)(1)(iv)(E).

\* \* \* \* \*

Par. 7. Section 1.401(a)(4)-9 is amended by:

1. Revising paragraphs (b)(2)(v)(A) and (b)(2)(v)(D)(3).
2. Adding paragraphs (b)(2)(v)(D)(4) and (5).
3. Redesignating paragraph (b)(2)(v)(F) as paragraph (b)(2)(v)(H).
4. Adding paragraphs (b)(2)(v)(F) and (b)(2)(v)(G).

The revisions and additions read as follows:

§1.401(a)(4)-9 Plan aggregation and restructuring.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(v) Eligibility for testing on a benefits basis--(A) General rule--(1) In general. Unless, for the plan year, a DB/DC plan is primarily defined benefit in character (within the meaning of paragraph (b)(2)(v)(B) of this section) or consists of broadly available separate plans (within the meaning of paragraph (b)(2)(v)(C) of this section), in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits, the DB/DC plan must satisfy the minimum aggregate allocation gateway (as described in paragraph (b)(2)(v)(D) of this section) except as provided in paragraph (b)(2)(v)(A)(2) of this section.

(2) Additional testing options. A DB/DC plan that is not eligible to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits under paragraph (b)(2)(v)(A)(1) of this section is permitted to demonstrate satisfaction of that requirement on the basis of benefits if the DB/DC plan satisfies either the closed plan rule of paragraph (b)(2)(v)(F) of this section or the lower interest rate rule of paragraph (b)(2)(v)(G) of this section.

(3) Effective/applicability date. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this paragraph (b)(2)(v)(A).

\* \* \* \* \*

(D) \* \* \*

(3) Averaging of rates for NHCEs--(i) Defined benefit plan. For purposes of this paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under a defined benefit plan that is part of the DB/DC plan as having an equivalent normal allocation rate equal to the average of the equivalent normal allocation rates under the defined benefit plan for all NHCEs benefitting under that plan.

(ii) Defined contribution plan. For purposes of this paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under a defined contribution plan that is part of the DB/DC plan as having an allocation rate equal to the average of the allocation rates under the defined contribution plan for all NHCEs benefitting under that plan.

(iii) Limitations on the averaging of rates. For purposes of applying paragraphs (b)(2)(v)(D)(3)(i) and (ii) of this section, any equivalent normal allocation rate or allocation rate in excess of 15% of plan year compensation is treated as being 15%. The preceding sentence is applied by substituting 25% for 15% each time it appears, but only if any allocation rate or equivalent normal allocation rate higher than 15% results solely from a plan design providing allocation rates or generating equivalent normal allocation rates that are a function of age or service under which higher rates are provided to older or longer-service employees.

(4) Use of matching contributions. For purposes of this paragraph (b)(2)(v)(D), if an NHCE is eligible for a matching contribution under a defined contribution plan that is part of the DB/DC plan, then the lesser of 3% and the

average matching contribution percentage for the group of eligible NHCEs in that plan is permitted to be added to the allocation rate for that NHCE. For this purpose, the average matching contribution percentage for the group of eligible NHCEs in a plan is the actual contribution percentage (within the meaning of §1.401(m)-5) for that group, determined without taking into account any employee contributions.

(5) Effective/applicability date. See §1.401(a)(4)-13(a)(4) for rules on the effective/applicability date of this paragraph (b)(2)(v)(D).

\* \* \* \* \*

(F) Closed plan rule--(1) In general. For a plan year that begins on or after the fifth anniversary of the closure date with respect to a closed defined benefit plan, a DB/DC plan that includes a closed defined benefit plan satisfies the closed plan rule of this paragraph (b)(2)(v)(F) for the plan year if--

(i) The closed defined benefit plan was in effect for the 5-year period ending on the closure date and neither the benefit formula nor the coverage of the plan was significantly changed by plan amendment (other than the closure amendment) with an effective date during the period that begins five years before the closure date and ends on the last day of the plan year; and

(ii) For each plan year that begins on or after the closure date and before the fifth anniversary of the closure date, one of the requirements in paragraph (b)(2)(v)(F)(2) of this section is satisfied.

(2) Testing for 5 years post-closure. A DB/DC plan meets the requirements of this paragraph (b)(2)(v)(F)(2) if--

(i) Each defined benefit plan that is part of the DB/DC plan satisfies the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits without aggregation with any defined contribution plan;

(ii) The DB/DC plan satisfies the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of contributions; or

(iii) The DB/DC plan satisfies the primarily defined benefit in character requirement of paragraph (b)(2)(v)(B) of this section, or the broadly available separate plans requirement of paragraph (b)(2)(v)(C) of this section.

(3) Certain amendments not taken into account. For purposes of this paragraph (b)(2)(v)(F), the following plan amendments are not taken into account:

(i) An amendment to the closed defined benefit plan adopted during the 5-year period ending on the closure date, provided that the accrued benefit or future accruals for any employee are not increased, coverage is not expanded, and the amendment is not discriminatory within the meaning of §1.401(a)(4)-8(b)(1)(iii)(D)(6).

(ii) An amendment adopted during the 5-year period ending on the closure date that extends the benefit formula with respect to the closed defined benefit plan to an acquired group of employees provided that all similarly situated employees within that group are treated in a consistent manner.

(iii) An amendment to the closed defined benefit plan that is adopted after the closure date that is not discriminatory within the meaning of §1.401(a)(4)-8(b)(1)(iii)(D)(6).



(iv) An amendment to the closed defined benefit plan that makes de minimis changes in the benefit formula

(v) An amendment that guidance published by the Commissioner in the Internal Revenue Bulletin provides will not be taken into account.

(G) Lower interest rate rule. A DB/DC plan satisfies the lower interest rate rule of this paragraph (b)(2)(v)(G) if the plan can demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits, provided that benefits are normalized using an interest rate of 6% rather than a standard interest rate.

\* \* \* \* \*

Par. 8. In §1.401(a)(4)-12, add definitions for *Closed defined benefit plan*, *Closure amendment*, *Closure date*, and *Grandfathered group of employees* in alphabetical order to read as follows:

§1.401(a)(4)-12 Definitions.

\* \* \* \* \*

*Closed defined benefit plan.* Closed defined benefit plan means a defined benefit plan that has been amended to--

(1) Cease accruals under a benefit formula provided by the defined benefit plan for some or all employees whose benefits were previously determined under that benefit formula; or

(2) Limit participation in the defined benefit plan to a group of employees that consists of some or all of the plan participants who participated in the plan as of the closure date.

*Closure amendment.* A closure amendment is a plan amendment that results in a closed defined benefit plan.

*Closure date.* A closure date is the last day before accruals cease or participation is limited pursuant to the closure amendment.

\* \* \* \* \*

*Grandfathered group of employees.* A grandfathered group of employees with respect to a closure amendment means the group of employees who, after the closure date, either continue accruals under the closed defined benefit plan's benefit formula or are entitled to an allocation formula under a defined contribution plan because those employees previously participated in the closed defined benefit plan.

\* \* \* \* \*

Par. 9. In §1.401(a)(4)-13, paragraph (a)(4) is added to read as follows:

§1.401(a)(4)-13 Effective dates and fresh-start rules.

(a) \* \* \*

(4) Effective/applicability date--(i) In general. Except as otherwise provided in this paragraph (a)(4), the rules of §1.401(a)(4)-2(c), §1.401(a)(4)-3(c)(2), §1.401(a)(4)-8(b), and §1.401(a)(4)-9(b)(2)(v)(A) and (D) apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final in the **Federal Register**.

(ii) Application for earlier plan years. Except as provided in paragraph (a)(4)(iii) of this section, taxpayers may apply §1.401(a)(4)-2(c), §1.401(a)(4)-3(c)(2), §1.401(a)(4)-8(b), or §1.401(a)(4)-9(b)(2)(v)(A) and (D) for plan years beginning on or after January 1, 2014 and before the effective/applicability date specified under paragraph (a)(4)(i) of this section. Alternatively, for these plan years, taxpayers may apply §1.401(a)(4)-2(c), §1.401(a)(4)-3(c)(2), §1.401(a)(4)-8(b), or §1.401(a)(4)-9(b)(2)(v)(A) and (D) as contained in 26 CFR part 1 revised April 1, 2015.

(iii) Certain rules not applicable until finalized. The rules of §1.401(a)(4)-9(b)(2)(v)(D)(3)(ii), (b)(2)(v)(D)(4), and (b)(2)(v)(G) are not permitted to be applied for plan years before the effective/applicability date specified in paragraph (a)(4)(i) of this section.

\* \* \* \* \*

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2016-01675 Filed: 1/28/2016 8:45 am; Publication Date: 1/29/2016]